Financial Review

(I) REVIEW OF 2012 RESULTS

The Group attained numerous new records for its financial results in 2012 with the reported core profit increased to a new high by 37% to HK$11,040 million from 2011 as prompted mainly by the Group's persistent growth in rental revenue and spiraling development property profit. Added to this by certain exceptional accounting gains and increase in investment property revaluation surplus, the Group's profit attributable to shareholders also increased to a new high by 55% to HK$47,263 million.

Revenue

Group revenue increased by 29% to HK$30,856 million (2011: HK$24,004 million), benefitting from the higher contribution from property sales achieved both in Hong Kong and the Mainland and the revenue increase achieved by the Property Investment segment.

Property Investment revenue from Hong Kong increased by 11% to HK$8,875 million, supported by the outstanding sales achieved by the retail tenants and the continuous positive rental reversions for office areas particularly in Harbour City and Times Square. In the Mainland, rental revenue increased by 26% to HK$1,005 million benefitting from the escalating revenue generated by Shanghai Wheelock Square as well as the renovated Chongqing Times Square. Hotel revenue increased by 9% to HK$1,391 million as sustained by the increase in room rates with occupancy remaining at a high level though this was adversely affected by the rooms renovation work for the Gateway Hotel. In aggregate, the segment reported an increase in revenue of 12% to HK$11,271 million.

Property Development continued to bear fruit with recognised sales increased by 92% to HK$12,207 million (2011: HK$6,343 million). Revenue recognition mainly derived from Chengdu Tian Fu Times Square, Shanghai Xi Yuan and Wuxi Times City in the Mainland totalling HK$9,573 million and from One Midtown in Hong Kong of HK$2,634 million.

During the year, inclusive of joint ventures and associates (other than Greentown) on an attributable basis, the Group recorded contracted property sales totalling RMB15.0 billion (2011: RMB12.7 billion) in more than ten cities in the Mainland, increasing its net order book to RMB15.7 billion by the year end 2012 (2011: RMB13.5 billion) pending for recognition on completion.

Logistics revenue dropped by 13% to HK$3,070 million (2011: HK$3,520 million) due to Modern Terminals' revenue decreasing with lower throughput handled as adversely affected by the slowdown in global trade growth.

CME revenue increased by 2% to HK$3,953 million (2011: HK$3,863 million), with revenue of Wharf T&T and i-CABLE increased by 4% and 1%, respectively.

Operating Profit

Group operating profit increased by 24% to HK$14,170 million (2011: HK$11,388 million) as supported by favourable profit contributions from Property Investment and Property Development.

Property Investment remained the Group's largest profit contributor with an 11% increase in operating profit to HK$8,578 million (2011: HK$7,694 million). Contributions from Harbour City (excluding hotels) and Times Square increased by 13% and 10%, respectively. Operating profit generated from its expanding properties portfolio in the Mainland grew decently by 29%, particularly benefitting from the Group's promising Shanghai Wheelock Square.

Hotels operating profit from the three Marco Polo hotels in Harbour City increased by 8% to HK$390 million although partly impacted by the above mentioned hotel renovation. Including the Mainland hotels, the operating profit increased by 5% only due to the adverse effects of the pre-operating expenses incurred for the new hotel which commenced operation in 2013.

Property Development, with higher property sales achieved and more property completions delivered, increased its operating profit by 114% to HK$4,869 million (2011: HK$2,274 million), including HK$3,562 million attributable to Mainland property projects and HK$1,307 million attributable to a Hong Kong property project, One Midtown.

Logistics' contribution dropped by 26% to HK$1,161 million (2011: HK$1,563 million), mainly due to a decrease in revenue of Modern Terminals.

CME reported a loss of HK$22 million (2011: profit of HK$45 million). Wharf T&T's operating profit increased by 9% to HK$250 million against i-CABLE's operating loss of HK$271 million.

Profit contribution from Investment and Others was HK$134 million (2011: HK$288 million).

Increase in Fair Value of Investment Properties

The book value of the Group's investment property portfolio as at 31 December 2012 increased to HK$231.5 billion (2011: HK$184.1 billion), with HK$210.1 billion thereof stated at fair value based on an independent valuation as at that date, which produced a revaluation surplus of HK$34,751 million (2011: HK$24,968 million), mainly reflecting the continuous strong rental growth of the Group's investment properties. The attributable net revaluation surplus of HK$33,336 million (2011: HK$23,841 million), after deducting related deferred tax and non-controlling interests, was credited to the consolidated income statement.

Investment properties under development in the amount of HK$21.4 billion are carried at cost and will not be carried at fair value until the earlier of their fair values first becoming reliably measurable or the dates of completion.

Other Net Income

Other net income for the year amounted to HK$2,483 million (2011: HK$457 million), mainly including the book accounting gain of HK$2,233 million arising from the acquisition of a 24.6% interest in Greentown as detailed in note 3(a) to the financial statements.

Finance Costs

Finance costs charged to the consolidated income statement were HK$939 million (2011: HK$2,567 million). These included an unrealised mark-to-market gain of HK$573 million (2011: loss of HK$1,387 million) on the cross currency/interest rate swaps in accordance with prevailing accounting standards. Net of non-controlling interests, the mark-to-market gain is HK$590 million (2011: loss of HK$1,356 million).

Excluding the unrealised mark-to-market gain, finance costs before capitalisation were HK$2,108 million (2011: HK$1,627 million), representing an increase of HK$481 million mainly as a result of the increase in gross borrowings and rise in effective borrowing rates. The Group's effective borrowing rate for the year was 2.8% (2011: 2.3%).

Excluding the unrealised mark-to-market gain, finance costs after capitalisation of HK$596 million (2011: HK$447 million) in respect of the Group's related assets were HK$1,512 million (2011: HK$1,180 million), representing an increase of HK$332 million.

Financial Review

Share of Results (after tax) of Associates and Jointly Controlled Entities

The attributable profit from associates increased by 308% to HK$1,473 million (2011: HK$361 million), mainly due to the first-time share of profit of HK$893 million for the period from 15 June 2012 to 31 December 2012 in Greentown, in which the Group has acquired a 24.6% interest during the year, and an increase in profit contributions from the Mainland development properties projects undertaken by other associates.

Jointly controlled entities' profit increased by HK$607 million to HK$641 million (2011: HK$34 million), reflecting their increased profit contributions from property development projects in the Mainland which began to bear fruit.

Income Tax

Taxation charge for the year was HK$4,215 million (2011: HK$3,304 million), which included deferred taxation of HK$1,087 million (2011: HK$901 million) provided for the current year's revaluation gain attributable to investment properties in the Mainland.

Excluding the above deferred tax, the tax charge increased by 30% to HK$3,128 million (2011: HK$2,403 million) mainly due to increase in profit recognised by Property Development segment.

Non-controlling Interests

Group profit attributable to non-controlling interests increased by HK$332 million to HK$1,101 million, reflecting the increase in net profits of certain non-wholly-owned subsidiaries.

Profit Attributable to Equity Shareholders

Group profit attributable to equity shareholders for the year ended 31 December 2012 amounted to HK$47,263 million (2011: HK$30,568 million), representing an increase of 55%. Basic earnings per share were HK$15.60, based on 3,029 million shares (2011: HK$10.22 based on a weighted average of 2,991 million shares after taking into account the effect of the Rights Issue).

Excluding the net investment property revaluation surplus of HK$33,336 million (2011: HK$23,841 million), Group profit attributable to equity shareholders for the year was HK$13,927 million (2011: HK$6,727 million), representing an increase of 107%.

Excluding the net investment property revaluation surplus and exceptional items, which included the book accounting gain arising from the acquisition of the interests in Greentown of HK$2,233 million and the attributable mark-to-market gains totalling HK$654 million (2011: loss of HK$1,356 million) on swaps and other financial assets, the Group's core profit rose by 37% to HK$11,040 million (2011: HK$8,083 million). Core earnings per share were HK$3.64 (2011: HK$2.70).

(II) LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL COMMITMENTS

Shareholders' and Total Equity

As at 31 December 2012, the Group's shareholders' equity increased by HK$45,244 million or 22% to HK$248,501 million, equivalent to HK$82.04 per share based on 3,029 million issued shares (31 December 2011: HK$67.10 per share based on 3,029 million issued shares).

Including the non-controlling interests, the Group's total equity increased by 22% to HK$256,906 million (31 December 2011: HK$210,874 million).

Total Assets

The Group's total assets increased by 16% to HK$369.0 billion (31 December 2011: HK$318.0 billion). Total business assets, excluding bank deposits and cash, certain available-for-sale investments, deferred tax assets and other derivative financial assets, increased by 22% to HK$343.9 billion (31 December 2011: HK$280.8 billion).

Included in the Group's total assets is the investment property portfolio of HK$231.5 billion, representing 67% of total business assets. The core assets in this portfolio are Harbour City and Times Square in Hong Kong, which are valued at HK$125.4 billion (excluding the three Marco Polo hotels) and HK$43.6 billion, respectively. Together, they represent 73% of the total value of the portfolio.

Other major business assets include other properties and fixed assets of HK$19.9 billion, interests in jointly controlled entities and associates (mainly for Mainland property and port projects) of HK$36.2 billion and properties under development and held for sale (mainly in the Mainland) of HK$48.9 billion.

Geographically, the Group's business assets in the Mainland, mainly properties and terminals, increased to HK$133.0 billion (31 December 2011: HK$110.6 billion), representing 39% of the Group's total business assets.

Debt and Gearing

The Group's net debt increased by HK$12.1 billion to HK$55.6 billion as at 31 December 2012 (31 December 2011: HK$43.5 billion), which was made up of HK$74.4 billion in debt and HK$18.8 billion in bank deposits and cash. Included in the Group's net debt was HK$6.4 billion (31 December 2011: HK$8.2 billion) attributable to Modern Terminals, Harbour Centre Development Limited ("HCDL") and other subsidiaries, which is without recourse to the Company and its other subsidiaries. Excluding these non-recourse debts, the Group's net debt was HK$49.2 billion (31 December 2011: HK$35.3 billion). Analysis of the net debt is set out below:

Net debt/(cash)	**31 December 2012 *HK$ Million***	31 December 2011 *HK$ Million*
Wharf (excluding below subsidiaries)	**49,201**	35,348
Modern Terminals	**11,193**	11,155
HCDL	**(4,581)**	(2,700)
i-CABLE	**(188)**	(338)
	55,625	43,465

As at 31 December 2012, the ratio of net debt to total equity was 21.7% (31 December 2011: 20.6%).

Financial Review

Finance and Availability of Facilities

The Group's total available loan facilities and issued debt securities as at 31 December 2012 amounting to HK$92.2 billion, of which HK$74.4 billion were utilised, are analysed as below:

	31 December 2012		
	Available Facilities *HK$ Billion*	Total Debt *HK$ Billion*	Undrawn Facilities *HK$ Billion*
Company/wholly-owned subsidiaries			
Committed bank facilities	41.0	28.3	12.7
Uncommitted bank facilities	0.4	–	0.4
Debt securities	30.5	30.5	–
	71.9	58.8	13.1
Non-wholly-owned subsidiaries			
Committed and uncommitted			
— Modern Terminals	13.7	12.3	1.4
— HCDL	6.1	3.2	2.9
— i-CABLE	0.5	0.1	0.4
	92.2	74.4	17.8

Of the above debt, HK$17.6 billion (31 December 2011: HK$20.1 billion) was secured by mortgages over certain properties under development, fixed assets and shares with a total carrying value of HK$28.2 billion (31 December 2011: HK$27.3 billion).

The Group has diversified the debt portfolio across a bundle of currencies including primarily Hong Kong dollar ("HKD"), United States dollar ("USD") and Renminbi ("RMB"). The funding sourced from such debt portfolio was mainly used to finance the Group's property development and port investments in the Mainland.

The use of derivative financial instruments is strictly monitored and controlled. The majority of the derivative financial instruments entered into by the Group were primarily used for management of the Group's interest rate and foreign currency exposures.

The Group continued to maintain a strong financial position with ample surplus cash denominated principally in HKD, USD and RMB and undrawn committed facilities to facilitate the Group's business and investment activities. As at 31 December 2012, the Group also maintained a portfolio of available-for-sale investments with an aggregate market value of HK$3.9 billion (31 December 2011: HK$2.7 billion), which is immediately available for liquidation for the Group's use.

Cash Flows for the Group's Operating and Investing Activities

For the year under review, the Group's net cash inflow before change in working capital increased to HK$15.1 billion (2011: HK$12.5 billion). The changes in working capital resulted in a net cash inflow of HK$1.9 billion (2011: outflow of HK$9.6 billion). For investing activities, the Group recorded a net cash outflow of HK$21.7 billion (2011: HK$18.4 billion), mainly for additions to investment properties, including the payment for the lease renewal premium of Ocean Terminal of HK$7.9 billion, land and construction costs for Chengdu IFS, investments in associates and jointly controlled entities involved in property development projects in the Mainland, including HK$2.7 billion paid for the acquisition of a 24.6% equity interest in Greentown, and subscription for Greentown's perpetual subordinated convertible securities of HK$2.6 billion. The net cash outflow was partly compensated by the proceeds received from disposal of certain non-core properties during the year.

Major Capital and Development Expenditure and Commitments

The Group's major capital and development expenditure incurred in 2012 are analysed as follows:

A. *Major capital and development expenditure*

	Hong Kong *HK$ Million*	Mainland China *HK$ Million*	Total *HK$ Million*
Properties			
Property investment	8,884	5,860	14,744
Development properties	787	13,321	14,108
	9,671	19,181	28,852
Non-properties			
Modern Terminals	175	436	611
Wharf T&T	504	2	506
i-CABLE	207	2	209
Others	5	–	5
	891	440	1,331
Group total	10,562	19,621	30,183

i. Property investment expenditure incurred during the year mainly included the lease renewal premium of HK$7.9 billion paid for Ocean Terminal and the land and construction costs for Chengdu IFS.

ii. The Group also incurred HK$14.1 billion for investment in development properties mainly related to Mainland projects, including HK$4.2 billion cash contribution to jointly controlled entities and associates and HK$2.7 billion incurred for the acquisition of a 24.6% interest in Greentown during the year under review.

iii. For Modern Terminals, the capital expenditure was mainly for additions to other fixed assets and the construction of the Da Chan Bay port project in the Mainland while that for Wharf T&T and i-CABLE was incurred substantially for procurement of production and broadcasting equipment, network rollout and internet service equipment. Modern Terminals and i-CABLE, respectively 67.6% and 73.8% owned by the Group, independently fund their own capital expenditure programmes.

Financial Review

B. *Commitments to capital and development expenditure*

As at 31 December 2012, the Group's major commitments to capital and development expenditure that is to be incurred in the forthcoming years was estimated at HK$87.5 billion, of which HK$24.0 billion was authorised and contracted for. By segment, the commitments are analysed as below:

	As at 31 December 2012		
	Authorised and contracted for *HK$ Million*	Authorised but not contracted for *HK$ Million*	Total *HK$ Million*
Property investment			
Hong Kong	1,132	824	1,956
Mainland China	7,197	20,031	27,228
	8,329	20,855	29,184
Development properties			
Hong Kong	164	638	802
Mainland China	15,383	41,133	56,516
	15,547	41,771	57,318
Non-properties			
Modern Terminals	30	420	450
Wharf T&T	119	289	408
i-CABLE	23	128	151
	172	837	1,009
Group total	24,048	63,463	87,511

Properties commitments are mainly for land and construction costs, inclusive of attributable commitments to joint ventures, to be incurred by stages in the forthcoming years. Attributable committed land cost of HK$6.1 billion is payable by 2013.

The above commitments and planned expenditure will be funded by Group's internal financial resources including its surplus cash of HK$18.8 billion, cash flow from operations, as well as bank and other financing with the construction costs self-financed mainly by pre-sale proceeds and project loans. Other available resources include available-for-sale investments.

(III) HUMAN RESOURCES

The Group had approximately 15,200 employees as at 31 December 2012, including about 2,800 employed by managed operations. Employees are remunerated according to their job responsibilities and the market pay trends with a discretionary annual performance bonus as variable pay for rewarding individual performance and contributions to the respective group's achievement and results.

(IV) BUSINESS MODEL

Select investment properties form the backbone of Wharf's business model. The total value they generate combine rental yield growth with annual capital appreciation. Their recurrent cash flow underpins a stable and rising dividend to shareholders. The conservatively leveraged equity cushion offers ample financial capacity to seize new investment opportunities in a timely and selective manner.

Including capital appreciation, the investment properties in operation offered a total return of HK$43 billion in 2012 on an asset base of HK$176 billion at the beginning of 2012. Harbour City and Times Square lead this prized portfolio of select investment properties and accounted for nearly 10% of total Hong Kong retail sales. With a combined GFA of over 10 million square feet and a market value of HK$177 billion, they generated HK$9.4 billion of revenue and HK$7.4 billion of operating profit in 2012.

New select investment properties under development are led by International Finance Square (IFS) in the very heart of Chengdu and Changsha. At a combined development cost of HK$40 billion, each of them will be as large as Harbour City and designed to be just as dominant in their respective markets. Three other IFSs are also under development in Chongqing, Wuxi and Suzhou.

This prized portfolio of select investment properties has also provided the financial capacity to enable Wharf to build other businesses.

From nearly a standing start, Wharf set out a bold policy in 2007 to put 50% of total assets in the Mainland in RMB over the following five years. Since then, Wharf has built itself into one of the most active Hong Kong developers in the Mainland. Inclusive of associated company Greentown, its attributable land bank comprises 18 million square meters across more than 40 cities. In 2012, contracted sales totaled RMB15 billion for 1.3 million square meters. Including the investment in Sino-Ocean Land, Wharf's total RMB portfolio relating to property investment in the Mainland totaled RMB99 billion or HK$122 billion.

In Hong Kong, the development land bank has a different scale and with a much higher AV per square foot comprises 3.2 million square feet. 2012 contracted sales totaled HK$3.5 billion for 0.9 million square feet. To selectively turn over this portfolio with timely acquisitions is the plan. The peak portfolio is a unique collection of properties which is being redeveloped over the next few years.

Outside of properties, other main business interests include hotel operation, container terminals and communications. All are recurrent earning based and many are land based.

(V) BUSINESS STRATEGY

The Group endeavours to continuously enhance its competitiveness and drive sustainable growth through:

1. Product leadership on new development projects to lead the local markets and on existing premises re-planning & improvement, tenant-mix refinement and effective marketing to maximise operating investment properties' rental growth and value;
2. Replicating the success of Harbour City and Times Square, location advantage, and our special relationship with leading tenants, soft power advantage, to expand the portfolio of select investment properties selectively in the Mainland to create substantial new value;
3. Applying core competencies in site selection and acquisition, development planning and design, construction, premium brand building and marketing to build up a young, fast growing and sustainable property development business in the Mainland to dovetail with the urbanisation programme locally;
4. Continuous development of sustainable and localised organisations in the different regions in the Mainland with local market know how and international standards and execution expertise; and
5. Exercising prudent and disciplined financial management to ensure sustainability at all times.